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The West German Economy: Outlook and Defense Implications

The West German economy is experiencing its longest slump in the postwar era. In 1982 Gross National Product declined for the second straight year; for 1983 as a whole, the Bonn government and five major economic research institutes forecast zero real GNP growth. West Germany depends on exports for well over one-quarter of its GNP, and economic recovery has been delayed by a sharp drop in export demand. Record government deficits, exacerbated by high unemployment and the restrained growth of tax revenues, pose a serious problem for the fiscally conservative government.

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Recent West German estimates point to a gradual investment-led recovery beginning in the latter half of 1983, stimulated by an expected upturn in global demand, declining interest rates, and favorable prospects for the construction industry. We believe the latest cut in oil prices--oil comprises about 14 percent of the value of West German imports--and the upswing in the US economy early this year will improve the outlook somewhat. The most politically sensitive economic indicator, unemployment, continues to worsen. The unemployment rate reached 10.4 percent last February--the highest in West German history--and Bonn is not optimistic that the numbers will improve significantly in the near future.

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Although unemployment problems will place a major strain on the federal budget, we believe the Kohl government will seek to impose rigid ceilings on social welfare spending programs. In 1983, social spending probably will decline in real terms--perhaps by as much as 8 percent--while the Defense Ministry's budget will increase by about 4 percent. Despite the priority attached to defense, however, the effects of a weak economy and budgetary austerity will be felt by the West German armed forces and defense industries.

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In response to NATO's 1982 Defense Planning Questionnaire, West Germany estimated that its total defense expenditures (by NATO accounting criteria) would increase by a nominal 4.1% in 1984, 3.8% in 1985, and 3.6% in 1986. We believe these estimates were based on overly optimistic projections of GDP growth and tax revenues and are likely to be revised by the Kohl government. After inflation is taken into account, real increases in defense spending for the next five years probably will not exceed 2%.

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The recession has taken its toll on key sectors of West Germany's defense industrial establishment. Illustrative of the defense industries' plight is the hardship currently experienced by Germany's two principal aerospace firms, Messerschmitt-Boelkow-Bloehm (MBB) and Dornier. Marketing problems for commercial aircraft, coupled with program stretching in combat aircraft production, led MBB to announce a lay-off of more than

10% of its 40,000-man work force last January. Reduced levels of government support for civil and military aircraft development is forcing private industry to use internal cash reserves for research and to seek international cooperation agreements to meet development costs. Production lines in Germany for the Tornado combat aircraft will close down by the late 1980s, and defense budget constraints have delayed a government decision on the next generation of air superiority fighters to replace the Luftwaffe's aging fleet of F-4 Phantoms. Faced with the possibility of an off-the-shelf buy of US-manufactured aircraft to meet this requirement, West German aerospace firms pin their hopes on some form of collaborative involvement, either with US or West European industries, to ensure future orders and retain their work force into the 1990s.

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New measures to forestall manpower shortages and to retain highly skilled technicians in each of the service branches--a top priority for Defense Minister Manfred Woerner--will require additional outlays for personnel in the coming years. We believe the West Germans will attempt to rely increasingly on the use of

combat simulators and small unit training as a means of holding down operating costs. The combat capabilities of the Bundeswehr probably will not decline seriously during the next five years, but Defense Ministry officials will be hard-pressed to maintain current levels of readiness.

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Woerner's enthusiasm for a more cost-effective exploitation of new technologies is reflected in moderately increased outlays for defense research and development, but the pay-off will not be realized until the 1990s. In the shorter term, unpaid bills on existing equipment acquisition programs will consume a substantial portion of capital investment funds. For the next four years almost 80 percent of the Bundeswehr's procurement budget is likely to remain committed. Major new programs cannot be undertaken during this period and we believe that current equipment modernization projects probably will not be accelerated.

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Although strongly committed to maintaining the Bundeswehr's peacetime strength and combat capabilities, West German officials have emphasized to their NATO partners on several recent occasions that very little latitude exists for additional defense commitments--including, for example, those which might be entailed by "out-of-area compensation" requests or West German funding for the US Army's Master Restationing Plan. We believe Bonn will insist, as it has in the past, that new defense initiatives affecting NATO member nations be carefully evaluated

and integrated from the outset into the Alliance's existing defense planning cycle. In any such deliberations the West Germans probably will argue strongly that new programs will compel member states to make explicit trade-offs with respect to existing force goals.

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